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Newspaper Agency Corporation v. Auditing Division, Utah State Tax Commission: Reply Brief

Utah Court of Appeals

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IN THE UTAH COURT OF APPEALS

NEWSPAPER AGENCY CORPORATION,	:	
Petitioner,	:	Case No. 940694-CA
v.	:	
AUDITING DIVISION, UTAH STATE TAX COMMISSION,	:	Priority No. 14
Respondent.	:	

REPLY BRIEF OF PETITIONER

PETITION FOR REVIEW OF A FINAL ORDER OF
THE UTAH STATE TAX COMMISSION

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REPLY BRIEF OF PETITIONER

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INTRODUCTION

Newspaper Agency Corporation (NAC) submits this brief in reply to the arguments advanced by the Auditing Division of the Utah State Tax Commission (Division) in its responsive brief. The basic theme of those arguments is that the Division and the Commission enjoy nearly unfettered discretion to determine the scope of the manufacturer's sales tax exemption contained in Utah Code Ann. § 59-12-104(16) (Supp. 1994), notwithstanding contrary decisions of this Court and the Utah Supreme Court which make clear that an agency's rules and actions must be consistent with the plain language of the governing statutes. In short, in arguing that the Commission's decision should be upheld, the Division refuses to apply, and in most instances even to acknowledge, settled principles of administrative law which clearly limit an agency's discretion in its interpretation and application of a governing statute.

The Division's arguments are addressed below, but not in the same order in which they appear in its brief.

ARGUMENT

REPLY TO THE DIVISION'S POINT I

CONTRARY TO THE DIVISION'S ASSERTION, THE DEFERENTIAL (REASONABLENESS) STANDARD OF REVIEW IS NOT THE ONLY STANDARD APPLICABLE TO THIS COURT'S REVIEW OF THE COMMISSION'S INTERPRETATION AND APPLICATION OF THE GOVERNING STATUTE; THE NONDEFERENTIAL (CORRECTION-OF-ERROR) STANDARD ALSO APPLIES

In discussing the applicable standard of review, the Division correctly states that the Commission's interpretation of the "new or expanding operations" and "normal operating replacements" language in Utah Code Ann. § 59-12-104(16) (Supp. 1989) (amended 1991, 1992, and 1994) is reviewed for reasonableness -- a deferential standard of review -- because section 59-12-104(16) grants the Commission discretion to define those terms. See Utah Code Ann. § 59-1-610(1)(b) (Supp. 1994); Putvin v. State Tax Comm'n, 837 P.2d 589, 591 (Utah App. 1992).

But, the Commission's interpretation of the crucial phrase "any manufacturing facility in Utah" in section 59-12-104(16) is reviewed for correctness -- a nondeferential standard of review. That is because the statute does not give the Commission discretion to define those terms. See Mt. Olympus Waters v. State Tax Comm'n, 877 P.2d 1271, 1272 (Utah App. 1994). The Division fails to note this distinction, erroneously claiming that this Court must deferentially review the Commission's interpretation of section 59-12-104(16) in all aspects.

REPLY TO THE DIVISION'S POINT III

THE DIVISION FAILS TO ANALYZE THE CENTRAL ISSUE OF WHETHER THE COMMISSION'S RULE MAY LIMIT THE SALES TAX EXEMPTION TO PURCHASES OF MACHINERY AND EQUIPMENT FOR A NEW PLANT AT A NEW LOCATION, IN LIGHT OF CONTRARY LANGUAGE IN THE GOVERNING STATUTE

A central issue in this case is whether the Commission's rule (Utah Admin. Code R865-19-85S.A.3(b) (1994)) may, in light of the plain language of section 59-12-104(16), limit the sales tax exemption to purchases of machinery and equipment for use in a new plant at a new location, as opposed to a new plant built, in whole or in part, on the site of its predecessor. The Division fails to analyze this critical issue, content to state the obvious -- i.e., the rule focuses on whether the manufacturing activities are begun at a "new location."

The Division has not even attempted to draw a rational distinction between the new plant/existing site scenario and the new plant/new site scenario; therefore, it must be assumed the Division is unable to conceive of one. Further, the Division makes no effort to square the rule's new location requirement with the plain meaning of section 59-12-104(16)'s "new or expanding" and "any manufacturing facility" language. Nor does it come to grips with the settled principle that an agency's rules must be consistent with the governing statutes, whether or not the agency has the discretion to define statutory terms.

In this vein, noticeably absent from the Division's brief is any analysis of the following key cases, which were thoroughly discussed in NAC's opening brief: Sanders Brine

Shrimp v. State Tax Comm'n, 846 P.2d 1304 (Utah 1993); Union Pacific R. Co. v. State Tax Comm'n, 842 P.2d 876 (Utah 1992); and Mt. Olympus Waters v. State Tax Comm'n, 877 P.2d 1271 (Utah App. 1994). It must be assumed that the Division's silence reflects its inability to reconcile the Commission's decision in the instant case with either the analysis or the result in any of those cases.

Finally, the Division argues that "[e]ven if the word 'location' were deleted from R865-19-85S.A.3(b), NAC could not qualify as a new or expanding operation . . . since it did not create a 'new' plant, but simply upgraded its prior operation." Br. of Appellee at 19. That argument is not supported by the record or the Commission's findings.

If the word "location " were deleted from subsection (b), the rule would allow the tax exemption where manufacturing activities are "begun in a new physical plant in Utah." No one could reasonably conclude that NAC did not construct a "new physical plant" given the following findings of the Commission:

> 11. NAC constructed and re-equipped the Regent Street plant during the audit period. The existing building was expanded by approximately 25% on property already owned by NAC. Forty percent of the building's walls were rebuilt. A new foundation was built to support new printing presses. New plumbing, electrical, ventilation, and cooling systems, as well as dust and ink collection systems, were installed.
>
> 12. NAC also purchased additional adjacent land for loading docks and truck parking.
>
> 13. NAC's cost to reconstruct its plant

> was 95% of what an entirely new building would have cost. The only significant saving was NAC's ability to use land which it already owned.
>
> 14. Before reconstruction, the Regent Street plant contained two letter presses and one offset press. The letter presses were removed from service, the existing offset press was reconfigured, and two new offset presses with supporting machinery and equipment were added. The cost of equipment for the Regent Street plant was 80% of the cost to equip a new plant.

Comm'n. Decision at 3-4 (R. 22-23).

In sum, the Division, like the Commission, offers no justification for the new location requirement contained in subsection (b) of the Commission's rule. Indeed, the plain language of the governing statute, when given its usually accepted meaning (as an agency must under clear precedent from this Court and the Utah Supreme Court), precludes such a limitation. NAC's new plant, therefore, meets the new plant requirement under a properly construed subsection (b), and NAC is entitled to the statutory sales tax exemption.

REPLY TO THE DIVISION'S POINTS II AND III

THE DIVISION IGNORES SUBSTANTIAL, UNDISPUTED RECORD EVIDENCE IN ARGUING THAT NAC DID NOT QUALIFY FOR SALES TAX EXEMPTION BECAUSE CONSTRUCTION OF ITS NEW PLANT WAS A MERE "RENOVATION" AND THAT THE NEW OFFSET PRESSES AND SUPPORTING EQUIPMENT WERE "NORMAL OPERATING REPLACEMENTS"

Throughout Points II and III of its brief, the Division characterizes NAC's construction of its new plant as a mere "renovation" and NAC's new offset presses and supporting equipment as "normal operating replacements." By employing these

characterizations, the Division seeks to justify the Commission's denial of section 59-12-104(16)'s sales tax exemption to NAC. The flaw in this approach is exposed by a simple examination of the record evidence, which does not support either the Division's characterizations or the Commission's ultimate conclusion that NAC's purchases of machinery and equipment were subject to sales tax.

In short, the Division confuses the issue by substituting labels for analysis. Before the Commission, NAC did not offer a set of its own labels. Rather, NAC brought in an undisputed newspaper facility expert, Kenneth Harding, who presented detailed, fact-based analysis which established that NAC's new plant was just that. With reference to explanatory charts and flow diagrams, Harding demonstrated that when analyzed from either a production flow or work process standpoint, NAC had established a "new operation."

A. The Division's Characterization Of NAC's New Plant Project As A "Renovation" Is Not Based On A Realistic Evaluation Of The Evidence

Although the Commission's decision never uses the term, the Division insists on characterizing NAC's new plant project as a "renovation." It does so in an effort to justify the Commission's conclusion that NAC did not satisfy subsection (a) of R865-19-85S.A.3., which allows the statutory sales tax exemption where manufacturing activities "are substantially different in nature, character, or purpose from prior activities." This characterization is "not based on a realistic

evaluation of the evidence." Jensen v. State Tax Comm'n, 835 P.2d 965, 970 (Utah 1992) (holding that the Commission's finding was not supported by substantial evidence).

The usual meaning of "renovate" is "to make fresh or sound again, as though new; [to] clean up, replace worn and broken parts in, repair, etc." Webster's New World Dictionary 1203 (2nd ed. 1984). A common synonym for renovation is "renewal." Id. "Renovation" plainly implies a return to a *prior*, newer condition which is not in need of repairs.

Although NAC's new plant concededly is in a "newer" state than was its former plant, it is not simply a newer replacement of its predecessor. The former plant and its letter presses were not worn out, broken, or in need of repair; they were in good condition and capable of continuing NAC's newspaper printing operation indefinitely. NAC's new plant is an entirely new system with dramatically increased capacity and production. Activities that were impracticable prior to construction of the new plant -- competitive commercial printing, preprints, advertisements in special formats, and target marketing -- are now significant, regular activities of NAC. In labelling NAC's project a "renovation," the Division fails either to acknowledge or to give due weight to these critical, uncontroverted facts.

An additional problem with the Division's use of the term "renovation" is that the word lacks precision in the context of determining whether something is a "new or expanding operation." As Kenneth Harding, the architect in charge of the

NAC project, explained at the hearing before the Commission:

> I think ["renovation" is] kind of a common term, that any time anyone embarks on a project that to a great degree maintains the existing walls or does something internally [to] a building, it's called a renovation or remodernization. I think that's a term typically used in the industry by architects and lay people as well. And it really has nothing to do with the intensity of what's happening. I mean, you could, in essence, change one office and have a modernization or renovation or gut it and start over and it's still a renovation. So I think it's a term that's kind of hinged with staying on the existing side and existing exterior shell of the building.

(T. 37-38). Having noted the definitional problem with "renovation," Harding concluded that NAC's new plant is, "from a production and process standpoint, . . . a new operation" (T. 38). The Division presented no contrary expert evidence.

At bottom, the Division, as was the Commission, is obligated to consider all the record evidence in analyzing the question whether NAC's new plant engages in the substantially different activities required by R865-19-85S.A.3(a). The Division does not do this. It fails to realistically evaluate *all* the evidence presented to the Commission, which firmly established that since the construction of its new plant, NAC has engaged in numerous activities that are substantially different from its traditional newspaper printing activities. The Division attempts to obscure this fact by using the convenient, but imprecise, label "renovation" in its incomplete review of the record evidence.

Finally, the Division's argument that, to satisfy

subsection (a), a manufacturer's new activities must "materially change the nature, character, or purpose of the activities conducted by NAC," Br. of Appellee at 23, is contrary to the plain language of both the rule and the governing statute. There is nothing in subsection (a) which requires that activities of a substantially different nature, character, or purpose must displace the primary activities of a manufacturer (in this case, printing, advertising, and circulation services for two daily newspapers). Moreover, such a construction conflicts directly with the plain meaning of the statutory language "new or *expanding* operations." § 59-12-104(16) (emphasis added).[1]

B. The Division Fails To Analyze Whether The Machinery And Equipment NAC Purchased For Its New Plant "Replace[d] Machinery Or Equipment Of A Similar Nature," As Set Forth In The Commission's Rule Defining "Normal Operating Replacements"

Throughout Points II and III of its brief, the Division insists that the machinery and equipment NAC purchased for its new plant were "normal operating replacements" and therefore not tax exempt. But, the Division fails even to cite the controlling language of the Commission's rule defining "normal operating replacements," and does not analyze the facts of this case in light of that rule.

In deciding that NAC did not meet the third alternative test for "new or expanding operation" set forth in subsection (c)

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[1] The Division's argument appears to be the product of its erroneous reading of the statutory phrase "new or expanding operations" to mean "new *and* expanding operations." See Br. of Appellee at 15, 18.

of R865-19-85S.A.3, the Commission stated that "[i]n substance, machinery and equipment that expands capacity satisfies the 'new and [sic] expanding operation' requirement only if the machinery and equipment does not replace existing machinery or equipment of a similar nature." Comm'n Decision at 14 (R. 33). Thus, the central issue, and that which is addressed in NAC's opening brief, is whether the Commission's interpretation and application of R865-19-85S.A.6's "of a similar nature" language[2] are in harmony with the plain meaning of the statutory terms "normal operating replacements."

The Division never addresses this central issue, lumping its discussion of the normal operating replacement exception with R865-19-85S.A.3(a)'s unrelated and independent requirement that manufacturing activities be "substantially different in nature, character, or purpose from prior activities." Therefore, NAC's arguments concerning the Commission's improper interpretation and application of R865-19-85S.A.3(c) stand unchallenged at the close of briefing.

CONCLUSION

Based on the foregoing arguments and those contained in NAC's opening brief, this Court should reverse the Commission's denial of the statutory sales tax exemption to NAC on purchases

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[2] R865-19-85S.A.6 defines "normal operating replacements" as "machinery or equipment which replaces existing machinery or equipment of a similar nature, even if the use results in increased plant production or capacity." Utah Admin. Code R865-19-85S.A.6 (1994).

of machinery and equipment for its new plant.

RESPECTFULLY submitted this 3rd day of January, 1995.

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CERTIFICATE OF SERVICE

I hereby certify that two true and accurate copies of the foregoing Reply Brief of Petitioner were hand-delivered to Gale K. Francis, Assistant Attorney General, Attorney for Respondent, Utah Attorney General's Office, 50 South Main Street, #900, Salt Lake City, Utah, 84144, and Kent W. Winterholler and Maxwell A. Miller, Parsons, Behle & Latimer, Attorneys for Amici Curiae, 201 South Main Street, Suite 1800, Salt Lake City, Utah 84145-0898, this 3rd day of January, 1995.

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